

# ENERGY PRICE INCREASES: IMPACT ON STATE AGENCY BUDGETS (NATURAL GAS)

A Report Prepared for the

**Legislative Finance Committee**

By  
Taryn Purdy

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**Legislative Fiscal Division**



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## INTRODUCTION AND PURPOSE

In the October meeting of the Legislative Finance Committee (LFC), staff presented a short paper on natural gas usage in state government and potential vulnerability to record high prices. At that time, the LFC asked for an update at the December meeting.

The purpose of this report is to provide an update on state expenditures for natural gas and the potential for programmatic impact of high natural gas prices. Due to timing issues, the report as mailed compares monthly agency natural gas expenditures through October. The report as presented at the meeting will include information through November.

## SUMMARY OF PREVIOUS INFORMATION

State government expenditures for natural gas are dominated by the Montana University System (MUS), which accounted for over 2/3 of all expenditures in FY 2004 and almost 60 percent of all expenditures in FY 2005. For the remainder of state government, those agencies with a number of buildings outside of the capitol complex in Helena generally pay for all natural gas expenditures from their HB 2 appropriation and bear the risk of any price changes. Buildings within the capitol complex in Helena pay for natural gas through rental charges by the Department of Administration. These charges are capped at the level approved by the 2005 Legislature, making the Department of Administration at risk to cost changes.

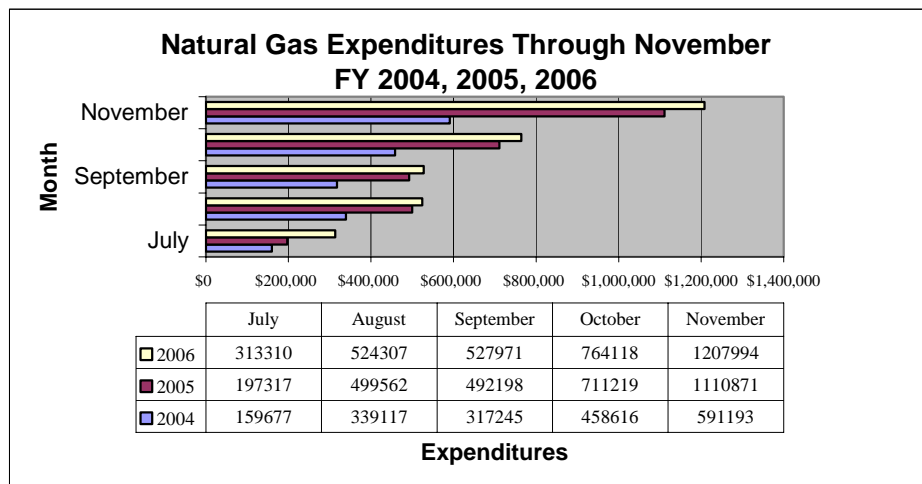
With the exception of the MUS, most state buildings are “on the meter”, meaning that they are subject to changes in natural gas prices as dictated by the market and consequently at risk from both higher prices and volatility of prices. Most of the MUS and the remaining state owned buildings are part of a contract with Jefferson Energy (Jetco), from which the state purchases the natural gas commodity. Consequently, many of the biggest users of natural gas (including the largest school districts) are protected both from volatility and from high prices (although the reverse is obviously true if prices fall).

The contract with Jetco runs through June 30, 2007 and totals \$6.66/dkthm for buildings without natural gas storage and \$6.86/dkth for agencies with natural gas storage. As of November 1 (the latest date available), Northwestern Energy’s default supply price was \$9.7656.

Buildings on and Off the State Contract 2007 Biennium	
On Contract	Off Contract - Sample, only
<u>Within Helena</u> Capitol and Capitol Annex Old Livestock (General Services Division) Mitchell (Administration and Revenue) Historical Society Cogswell (DPHHS) Transportation FWP (main building) DPHHS Metcalf (DEQ) New Justice/State Library Scott Hart (Agriculture and Livestock) Walt Sullivan (Labor and Industry)	Military Affairs OPI Corrections Commerce Main DNRC Building MSU - Billings Pine Hills School State Fund Building Law Enforcement Academy Other MDT buildings
<u>Out of Helena</u> Montana State Hospital - Warm Springs Montana State Prison - Deer Lodge Montana Developmental Center - Boulder Montana Veterans Home - Columbia Falls Montana Mental Health Nursing - Lewistown	
Montana University System MSU MSU - Northern MSU - Bob Miller Pavilion MSU - Marsh Lab MSU Firm Gas Meter MSU Family Student Housing UM UM - Montana Tech UM - Western UM Scisson Criaghead Apartments	

## UPDATE

The following chart shows expenditures of state government for natural gas through October. (As stated earlier, an update of expenditures through November will be made prior to the December meeting and this report will be updated at that time.)



As shown in the chart, expenditures are still trending significantly higher than the base year, which the legislature inflated 18 percent for FY 2006 and 12 percent for FY 2007. The following extrapolates expenditures so far in FY 2006 based upon the average expenditures for the previous two years, and compares it to the amount in the state's budgeting system at the end of the last legislative session for several high usage agencies. This figure is not meant to predict costs through the year, but is instead designed to highlight potential pressure areas. The legislature does not budget at this level, and agencies can utilize other operating expense appropriations to pay for natural gas (or other expenses) and move appropriations such as personal services to operating expenses with proper documentation and approval. However, the chart does show the degree to which some agencies may have to prioritize other expenditures to pay natural gas costs.

Please note two things:

- 1) For a majority of the costs represented in the chart, an extrapolation will be valid for price changes because of the consistency of the contract amount, but will be less so for those agencies "on the meter" due to price volatility. Also, no weather related factors in total cost changes are accounted for.
- 2) The Montana University System is funded through a formula amount that does not specify the amount in MBARS for natural gas at the units. The information in the table is based upon utilities budgets paid for with current unrestricted funds for the 2007 biennium and the percent of that budget that is natural gas, both as reported by the system. However, please note that the percentage that natural gas represents of the total utilities costs is based on historical averages, and may not accurately equate to expenditures in the 2007 biennium due to the increase in natural gas costs. Because the table only includes current unrestricted funds, it consequently does not include such facilities as student housing. Various campuses of the university system have instituted student surcharges to cover some of the anticipated shortfalls in funding, which are not included in the table.

Extrapolated Expenditures Compared to Appropriation Selected Agencies			
Agency	FY 2006 Appropriation	Extrapolated Expenditures	Difference
Administration*	\$674,165	\$641,300	\$32,865
DPHHS	603,217	664,136	(60,919)
Military Affairs	558,053	1,008,096	(450,043)
Corrections	616,706	1,031,488	(414,782)
Transportation	544,060	624,333	(80,273)
FWP	147,077	150,711	(3,634)
UM**	1,896,708	2,526,439	(629,731)
MSU**	2,628,367	2,516,314	112,053
*Rent charged to agencies assumed an 18 percent increase in natural gas prices			
**From the Montana University System. Appropriation includes estimated surcharge collections			

As shown, the Department of Corrections and the Department of Military Affairs currently show a significantly higher rate of expenditure than could be sustained by the level of natural gas consumption assumed in the appropriation. If current expenditure patterns continue, those departments would have to reallocate expenditures from other areas to stay within appropriations, in the case of the Department of Corrections exacerbating the current shortages caused by population and pay increases. Please note that the Department of Military Affairs has received significant budget amendment authority in the past, a portion of which has been used to fund natural gas costs. The figure does not assume any budget amendment authority.

At the same time, futures prices have shown a significant decline, and prices on the natural gas spot market are not trending as high as the previous two months, signaling at least some respite from the recent high volatility and spiking prices (although recent prices have begun to trend higher). How this will translate into costs actually paid by state government is unclear at this time, due in part to the long-term nature of many natural gas purchase contracts and the potential need for additional purchase on the spot market, and the lag in manifestation in the price of the commodity itself. The following shows the daily average spot price on the Calgary exchange. It is from Alberta that most gas consumed in Montana comes.

Please note that this figure is in Canadian currency. As of December 2, 2005, the rate of exchange was \$1.16 (rounded) CAD to \$1USD. The November weighted average in \$USD was therefore \$7.56.

Staff will continue to monitor this issue as winter progresses.

Next Day Price Index Value Calgary Exchange	
Time	Price
Last Trading Date*	\$11.5162
<u>Weighted Averages</u>	
November	\$8.7855
October	11.7990
September	10.5432
August	8.7143
July	7.0814
June	6.9448
In Canadian currency	
*December 1	

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